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TAGS: EFIN ETRD EAGR HO
SUBJECT: IMF PESSIMISTIC ABOUT PROSPECTS FOR A STANDBY AGREEMENT

REF: TEGUCIGALPA 1114

Classified By: AMBASSADOR HUGO LLORENS FOR REASONS 1.4 (B & D).

¶1. (C) Summary: An International Monetary Fund team has been in Tegucigalpa the past two weeks conducting Article IV consultations. In an out-brief meeting, they told us that the Honduran government,s unwillingness to allow for exchange rate flexibility makes the extension of the Stand by Arrangement beyond its March 31 expiration date unlikely. In the absence of exchange rate flexibility, the only other sure way to minimize pressure on the balance of payments and reserves was to take even stronger steps on the fiscal side. In the absence of a program, the IMF officials suggested that the GOH seek to maintain a strong fiscal position to ensure macroeconomic stability and provide an opportunity for a future government in 2010 to engage the Fund in serious negotiations. The Ambassador briefed the delegation on the delicate political situation here and raised the possibility that the international financial community consider accelerating disbursements of non-policy based assistance in an effort to support the most basic human needs of the poorest Hondurans, or those who had lost their jobs and were made destitute due to the global economic crisis. End Summary.

¶2. (C) The International Monetary Fund (IMF) sent a team to Honduras for routine Article IV consultations February 23-March 5. In addition to their March 4 meeting with the Ambassador, the team met with GOH officials, both Presidential candidates and Cardinal Rodriguez. Delegation Chief Alejandro Lopez conveyed his concerns about the prevailing climate of political uncertainty in Honduras. He also noted that the Honduran economy was being impacted by the global downturn and that the IMF had made downward revisions in GDP growth for 2009 from 3.4 percent to 1.5-2.0 percent. On the positive side, the decline in oil prices was expected to reduce balance of payments pressures with the deficit in the current account declining from a record 15 percent of GDP to a projected 9 percent of GDP. Thus, while Honduras was expected to lose about USD 250-300 million in foreign reserves, it does not foresee a balance of payment crisis in 2009. The Central Bank still has about USD 2.5 billion in net reserves, sufficient to cover about three months of imports. Lopez pointed out that the GOH had done well in managing its public finances in 2008, meeting IMF program targets for the fiscal deficit of only 1.6 percent of GDP. Nevertheless, the GOH,s shortfall on the monetary side and its failure to allow the exchange rate to decline in value had ensured that the Honduran government was in non-compliance with the program.

¶3. (C) Lopez doubted that the GOH would be able to extend the

terms of the current IMF agreement beyond its scheduled expiration date of March 31. He said that GOH refusal to permit exchange rate flexibility, even a minimal depreciation of 5 percent, made a program extremely unlikely. Once the program expired, a completely new program would have to be renegotiated and that would take a very long time involving negotiations, preparing an agreement and securing IMF Board approval. However, Lopez said that in the absence of an IMF agreement, the GOH could still seek to maintain macroeconomic stability by committing itself to adopting sound fiscal policies. He suggested that the Hondurans enact a fiscal budget -- due to be considered by the National Congress in April -- that was sound and serve as an anchor for economic stability. Lopez said assuming the fiscal situation was relatively strong, it would help the new government in seeking IMF help in early 2010.

¶4. (C) The Ambassador noted that an estimated 30,000 jobs had already been lost, or nearly 20 percent of sector jobs. The result was great economic and social dislocation particularly in the industrial heartland of San Pedro Sula and the North Coast. The Ambassador recognized that the Zelaya government had a weak economic policy record. He said the Embassy would continue to urge the government to seek serious negotiations with the IMF and point out the many financial and economic advantages to be derived from extending its current program. Nevertheless, he suggested that the severity of the economic crisis called for creative thinking in Washington with respect to how to help the poorest Hondurans who needed help, particularly in terms of faster disbursement of non-policy based program money.

¶5. (C) Lopez agreed that the difficult situation in Honduras

required the international financial community to provide robust assistance in times of crisis. On the positive side, he said that the IDB and World Bank were seeking to accelerate and reprogram non-policy-based disbursements of funds to cover the basic human needs of the poorest Hondurans. He also suggested a greater effort to facilitate the flows of credit from the private sector arms of the multilateral banks to the Honduran private sector.

¶6. (C) Comment: President Zelaya has painted himself into a corner with his public refusal to allow for a gradual devaluation of the Lempira. In part he has taken this position on advice from several wealthy bankers who stand to lose on major dollar-denominated debts if the lempira slides in value. Nevertheless, the IMF continues to offer him an out. A Standby Agreement could unleash substantial additional financial support from the World Bank, Interamerican Development Bank and European donors and also give greater confidence to private investors considering investing in Honduras. We will continue to encourage the GOH to seek an agreement with the IMF. However, with the growing probability that an agreement may not be in the cards, we agree with the Fund that an effort to put in place fiscal and other policies to ensure macroeconomic stability may well be the second best possible option. We will continue to discuss with the GOH and Congressional leadership on the importance of adopting a strong budget package designed to help the poorest of the poor, implement a sufficient level of public investment to generate jobs, and eliminate wasteful non-impact spending to ensure relative balance.
LLORENS